

May 2, 2006

**Minutes Of The Meeting Of The
Treasury Borrowing Advisory Committee
Of The Bond Market Association
May 2, 2006**

The Committee convened in closed session at the Hay-Adams Hotel at 11:40 a.m. All Committee members were present except Gary Cohn and Rick Rieder. Under Secretary Randy Quarles, Assistant Secretary Emil Henry, Deputy Assistant Secretary James Clouse and Office of Debt Management Director Jeff Huther welcomed the Committee and gave them the charge.

The Committee addressed the first question in the Committee charge (attached) regarding development of a framework for evaluating Treasury's liability portfolio. Deputy Assistant Secretary Clouse presented a series of slides regarding Treasury efforts to develop an analytical framework for evaluating Treasury's portfolio choices on issues such as maturity composition, the appropriate mix of nominal versus inflation-protected securities, and other aspects of debt management. He indicated that Treasury expects to have preliminary materials for the Committee to review at the August Quarterly Refunding.

In their discussion of the proposed framework, one Committee member asked whether Treasury would share the framework with the market or keep this material in-house. Mr. Clouse indicated that Treasury would need to review this matter and would welcome the advice of the Committee on this score. There was some concern public release of a framework might give a false sense of confidence about what Treasury would do in terms of future issuance. Others noted that public release of aspects of an analytical framework would enhance Treasury market transparency. Several Committee members noted that they felt that the portfolio analysis project that Treasury was undertaking was better described as a "framework" than a "model." A framework was viewed as a tool that could inform Treasury's decision making process rather than a rigid model that would generate explicit prescriptions for debt management decisions.

The Committee then discussed the integration of average maturity into a modelling framework. Mr. Clouse noted that while the framework would imply an average maturity, it would not be a framework constraint. One Committee member noted that the model, as described by Mr. Clouse, would implicitly address average maturity through expected interest costs and variance of interest costs – i.e., that big changes in average maturity would show up through these variables.

One Committee member asked whether Treasury should think about an asset-liability management (ALM) framework as opposed to a framework that was purely focused on liabilities. Under Secretary Quarles noted that the U.S. government's primary asset was its ability to tax and that an asset of this type was difficult to evaluate. A different Committee member noted that France had undertaken an ALM review and

noted that this review had served, in part, to inform France's decision to issue inflation linked debt.

Finally, one Committee member stated that the inputs required for this framework would be difficult to estimate and suggested that it would be useful to conduct sensitivity tests of the outputs to user defined assumptions. Another member suggested that, to ensure consistency of units of measure, it might be useful to separate the interest cost and variability components from the liquidity and rollover costs and view the liquidity and rollover components as constraints.

The Committee then addressed the second question in the charge regarding the Committee's views on the establishment of a backstop Treasury securities lending facility. Director Huther presented the Committee with several slides and asked whether the Committee could discuss the pros and cons of such a facility and if they had any specific comments on the structure as described in the recently-released public discussion paper. Assistant Secretary Henry followed up, noting that to date Treasury had received mixed feedback from the market on the facility and that the Committee should not conclude that Treasury was set on this path merely because Treasury had raised the question.

In their discussion of the securities lending facility proposal, Committee members noted that the market was working on solutions to resolving fails and thus it was not clear that a Treasury facility was needed. One member observed that the cost to dealers of implementing such a facility had not been quantified. Another member agreed that it might make sense for Treasury to wait and see whether the new mechanisms that the market was working on (particularly the potential for greater activity in repo at negative interest rates) would solve the problem. A different member questioned how a securities lending facility would solve a structural imbalance in supply and demand for a security. Finally, another member observed that in crisis circumstances Treasury could always reopen a security to alleviate fails and stated that this was probably an adequate tool in extreme situations.

By contrast, a different Committee member observed that the reopening Treasury undertaken five years ago in the aftermath of September 11th had only brought forward planned supply as opposed to fundamentally changing its auction calendar. He noted that it could be useful for Treasury to have authority to engage in securities lending. Another Committee member argued that unscheduled reopenings could change investor perceptions of Treasury – i.e., run counter to Treasury's regular and predictable approach to debt management and result in a risk premium. A different member disagreed stating that an unscheduled reopening once every five or ten years in response to a severe market dislocation was unlikely to affect the market's perception of Treasury debt management.

One Committee member questioned whether creation of a securities' lending facility might increase Treasury's borrowing cost by reducing the scarcity value of Treasury securities. He also said that he believed that such a facility could reduce the potential costs to market participants of being short Treasuries.

A different Committee member stated that while 99 percent of the time it was better for the government to not interfere in markets, the creation of a securities lending facility as a potential tool to address extreme fails situations was beneficial and worth the effort. This member noted that such a facility could reduce concerns about tail risk which would be of benefit to market participants. However, the member stated that Treasury needed to reflect more on how and when the facility would be used. Another member stated that he thought such a facility would have been appropriate for Treasury to have used after September 11, 2001, but that it would have been inappropriate for Treasury to have used it in 2003. He stated that he didn't see any harm in Treasury having another tool at its disposal.

Under Secretary Quarles asked whether additional supply provided by a securities lending facility after September 11th would have been preferable to the Treasury's decision to reopen a security. A Committee member stated that the biggest problem after September 11th was accounting and that once the accounting issues were cleared up, fails remained in only a few securities. A different member reminded others that following September 11th, the TBAC had recommended that Treasury establish a securities lending facility as a means of addressing crises rather than relying upon unscheduled reopenings. Another member observed that the next crisis was unlikely to be similar to September 11th – hence it probably wasn't useful to overly focus the discussion of the pros and cons of a securities lending facility on the specifics of that event. A member asked others on the Committee if a securities lending facility wasn't a more moderate response to a situation of extreme fails than an unscheduled reopening. Another member responded that it was but only if such a securities lending facility was used very selectively. In closing, the Chairman noted that Committee members had varied views and opinions on this topic which he would try to represent as best as possible in the Committee's summary.

Finally, the Committee was asked about options for Treasury bond issuance going forward. Director Huther presented a slide describing several options and asked the Committee whether Treasury should seek to reinvigorate the May/November strip. One Committee member said that Treasury should move to quarterly bond issuance. He also noted that he believed quarterly auctions would imply issuance at the upper end of the range Treasury had given the market as initial guidance on supply. Another member asked if Treasury moved to quarterly auctions if the issue sizes might be too small and cause them to trade special. The first member replied that they were saying the same thing – i.e., that if Treasury were to move to quarterly auctions it would need to increase the size of annual bond issuance. This member also noted the gap in maturities between 2031 and 2036, and suggested that having May/November STRIPS, in addition to February/August STRIPS, would make a more complete curve. This member stated that he thought there was sufficient demand to move to quarterly auctions. However, another member cautioned that the pension demand for long-dated bonds was not ubiquitous and that while some companies are moving towards immunization strategies; other pension funds are moving in the opposite direction. Finally, one Committee member asked whether Treasury should consider issuing 50-year bonds. Committee members discussed

this briefly and concluded that Treasury should first meet any additional long-dated demand through the expansion of 30-year issuance.

The meeting adjourned at 1 p.m.

The Committee reconvened at the Hay-Adams Hotel at 6:00 p.m. All the Committee members were present. The Chairman presented the Committee report to Assistant Secretary Henry. A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 6:20 p.m.

Jeff Huther
Director
Office of Debt Management
May 2, 2006

Certified by:

Ian Banwell, Chairman
Treasury Borrowing Advisory Committee
Of The Bond Market Association
May 2, 2006

Attachments:

Link to the Treasury Borrowing Advisory Committee discussion charts

[U.S. Treasury - Office of Domestic Finance](#)

**Treasury Borrowing Advisory Committee Quarterly Meeting
Committee Charge – May 2, 2006**

Portfolio Composition

In developing a framework for evaluating our portfolio, we have modeled characteristics of a steady state portfolio that could be used to address basic questions of optimal portfolio composition. Recognizing the limitations inherent in models of this sort, we would like the Committee's views on this framework in contemplating future debt management policy choices and Committee suggestions on how to further develop guidelines on portfolio composition.

Securities Lending Facility

In August and November 2005, we sought the Committee's views on the establishment of a backstop Treasury securities lending facility. The Committee expressed the view that in addition to not inadvertently disrupting a well functioning market, the benefits of such a facility must outweigh the costs. Treasury recently distributed to the public a white paper outlining a prototype of a Securities Lender of Last Resort (SLLR) facility. We would like the Committee's views on the potential costs and benefits associated with a SLLR as described in the paper. In addition, we would like the Committee's views on the proposed structure including various terms and conditions.

Thirty-Year Coupon Cycle

We seek the Committee's views on developments in the bond market, including the demand for long duration and the need to maintain a liquid STRIPS curve. In the context of overall bond market conditions and the Committee's assessment of Treasury financing needs in FY 2007, does the Committee see a need to add a May-November coupon cycle to Treasury's 30-year bond issuance? If the Committee sees a need to add a May-November coupon cycle in 2007, what are the Committee's recommendations for implementation?

Financing this Quarter

We would like the Committee's advice on the following:

- The composition of Treasury notes to refund approximately \$59.9 billion of privately held notes and bonds maturing or called on May 15, 2006.
- The composition of Treasury marketable financing for the remainder of the April-June quarter, including cash management bills.
- The composition of Treasury marketable financing for the July-September quarter.